



## Specialist Debt Advice Service Spotlight July 2019

Shelter

### **Contingent liabilities and insolvency**

In this month's Spotlight we will cover contingent liabilities, and why identifying them is so important when advising about insolvency options.

The law on including debts payable in future is different for bankruptcy, Debt Relief Orders (DROs) and Individual Voluntary Arrangements (IVAs). To explore this difference in more detail we will look at 2 different types of debt: council tax and guarantee debts.

First let's look at the legislation. Part 11 Insolvency Act 1986 contains the definitions used throughout the act. [S382](#) defines bankruptcy debt as any debt or liability to which he is subject at the commencement of the bankruptcy, or any debt or liability to which he may become subject after the commencement of the bankruptcy (including after his discharge from bankruptcy) by reason of any obligation incurred before the commencement of the bankruptcy.

For Debt Relief Orders the rules are slightly different. The equivalent provision is in [s251A](#) of the Insolvency Act 1986, which defines a qualifying debt as a liquidated sum payable either immediately or at some certain future time. Describing a debt as liquidated means the amount of money is fixed.

### **Council tax**

Council tax liability is calculated on a daily basis in accordance with [s.2 of the Local Government Finance Act 1992](#). Because of this, the bill sent out at the beginning of the tax year is just an estimate of liability.

### **Debt Relief Order**

The 2009 Judicial Review case of [R \(Mohammed\) v Southwark LBC](#) [2009] EWHC 311 (Admin) clarifies when the full years liability for council tax becomes due and payable. The Administrative Court commented at paragraph 32:

*“It follows from the Regulations that if a resident to whom a demand for a payment on account of council tax is properly addressed fails to pay an instalment on time, or fails to respond quickly enough to a reminder notice, or a final notice, he may become liable to pay the whole balance of the estimated amount of tax for that financial year within a short period, normally 7 days. The council will then be entitled to seek a liability order against him for that amount if it is wholly or partly unpaid”*

So, if the client is up to date with their instalments, no amount should be scheduled in the DRO application as the future payments are contingent on the daily calculations but if the debtor has lost the right to pay by instalments, the entire debt should be scheduled.

### **Bankruptcy**

Unlike Debt Relief Orders, which rely on the debt being for a liquidated sum payable at some certain future time, bankruptcy includes certain contingent liabilities.

The definition was clarified in the Supreme Court case [Re Nortel](#) [2013] UKSC 52. The court confirmed that bankruptcy includes all liabilities that arose from a statutory or contractual relationship that existed before the date of the bankruptcy.

As any potential liability for the current year's council tax would have been based on an obligation to pay council tax incurred before the commencement of bankruptcy, any bill issued in respect of such liabilities would be contingent liabilities and prove as bankruptcy debts. This is the case even if no bill is issued until after the date of the bankruptcy order.

### **Individual Voluntary Arrangement**

IVA's reflect the same principles as bankruptcy. The case of [Kaye v South Oxfordshire District Council](#) [2014] EWHC involved business rates in a Company Voluntary Arrangement. The rates had not been called in by a final reminder but were contingent liabilities for insolvency in that they were still due, contingent on a final reminder.

### **Guarantee debts**

Where a guarantor is in financial difficulties it might be appropriate for them to consider personal insolvency. The rules about guarantees in bankruptcy, DROs and IVAs are slightly different for each one and need to be considered carefully.

## **Bankruptcy**

Guarantee liabilities will prove in a guarantor's bankruptcy whether or not the debtor has not defaulted, and the guarantee has become due and payable. Where the debtor has not defaulted the guarantee will constitute a contingent liability.

## **Guarantees in a Debt Relief Order**

Whether or not a guarantee constitutes a DRO qualifying debt depends on the agreement. It may be automatic, following the default of the debtor and expiry of a properly served default notice or it could require expiry of the default notice and a demand for payment from the creditor. Default notices must be served on the debtor and the guarantor.

It is important to check the agreement and the notices if there is any uncertainty about whether the guarantee has been called in. For a Consumer Credit Act 1974 regulated agreement, a guarantee will become a liquidated sum and therefore a qualifying debt, when a default notice has been served on both the debtor ([s87\(1\)\(e\)](#)) and the guarantor ([S111\(1\)](#)). Agreements should be checked for enforceability and to determine when the guarantor's liability crystallises and becomes a qualifying debt.

Voluntary payment by the guarantor does not count as enforcing security nor is requesting payment, provided it is made clear it is not a demand, so it is important to check notices and the agreement when scheduling a guarantee debt in a DRO, even where the debtor has been asked to make payments.

## **Guarantees in an Individual Voluntary Arrangement**

Where the guarantor makes an IVA proposal the guarantee liability should be included. If the guarantee has crystallised (become enforceable – see above) the creditor will have voting rights. In accordance with rule [r15.31\(3\) of the Insolvency Rules 2016](#) where the liability is not yet due and payable the debt will be listed as £1.00 unless the convener decides to give a higher estimated value. Importantly, the creditor will have no voting rights. In *Fender v IRC* [2003] BPIR 1304\* at para 15 the court rejected the argument that the holder of a guarantee was entitled to vote in respect of the debtor's maximum possible liability under it, even though no sum was payable at the date of the creditors' meeting and the actual sum that might ultimately be payable could not be determined.

An Insolvency practitioner from a reputable firm has stated that guarantor lenders tend to vote against IVAs but would have no voting rights as long as the guarantee liability has not

been crystallised. This is particularly useful for homeowners wishing to avoid enforcement by a charging order. Uncrystallised guarantees will still be bound by the IVA and the guarantor's liability will be discharged if it successfully concludes - [Re T&N Ltd and others \(No 2\)](#) [2005] EWHC 2870 (Ch).

We hope this has clarified some of the issues that come up for debts payable in future, particularly when it comes to DROs. Lots of types of debts have payments that are not yet due, but they can be included as long as they are for a fixed sum of money and there is a due date for payment. For bankruptcy, as long as the obligation to pay existed at the time the order was made, the liability will be included. If you'd like a second opinion on whether a debt constitutes a contingent liability, please get in touch with us by phone or through the webform.

\*The Bankruptcy and Personal Insolvency Law Reports are not publicly available.